

Internal Revenue Service
Office of Federal, State and Local Governments

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FSLG Newsletter ~ July 2009

This is the semiannual newsletter of the office of Federal, State and Local Governments (FSLG) of the Internal Revenue Service. Our mission is to ensure compliance by Federal, state, and local governmental entities with Federal employment and other tax laws through review as well as educational programs.

For more information, visit our web site at www.irs.gov/govt. For account-related assistance, contact Customer Account Services at 1-877-829-5500. To identify a local FSLG Specialist, see the directory at the end of this newsletter.

The explanations and examples in this publication reflect the interpretation by the IRS of tax laws, regulations, and court decisions. The articles are intended for general guidance only, and are not intended to provide a specific legal determination with respect to a particular set of circumstances. You may contact the IRS for additional information. You may also want to consult a tax advisor to address your situation.

Federal, State and Local Governments

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PAUL MARMOLEJO NAMED DIRECTOR OF FSLG

In March, Federal, State and Local Governments welcomed Paul Marmolejo as its new Director. Paul brings a wealth of leadership experience to the organization, with ten years as a senior manager.

Paul began his career in 1984 as a Revenue Agent in San Jose, California. He has served in various RA positions of increasing responsibility including district technical coordinator as well as Examination Group manager in 1995. In January 1999, he served as the Branch Chief of the Fresno Area Compliance Office and was responsible for examination, collection and taxpayer service programs for the Fresno Metropolitan Area. In 2000, he served as territory manager for the Small Business/Self Employed (SB/SE) business unit in Fresno.

Paul has served on a number of long term assignments as assistant director for the Gulf States and California Areas in SB/SE and has represented the Service at various practitioner and Federal and state meetings throughout California. He recently served as the Chief of Operations for SB/SE Technical Services, which is responsible for various examination support programs including review.

When asked for his vision for FSLG, Paul said, "I will strive to achieve a greater overall balance between service and enforcement to ensure that we effectively carryout these roles in line with our strategic business plan. In addition, I will increase our service focus on providing guidance to our taxpayers so that they can effectively identify potential compliance issues and self-correct issues as necessary. To effectively carry out this vision, it will be critical to leverage the knowledge and support from our key stakeholder groups."

CONTINUING COVERAGE INSURANCE SUBSIDY UNDER COBRA

BY STEWART ROULEAU, FSLG SENIOR ANALYST

The American Recovery and Reinvestment Act of 2009 (ARRA) includes changes to the health benefit provisions of the Consolidated Omnibus Budget Reconciliation Act of 1985, commonly referred to as COBRA. The new law affects many involuntarily terminated employees and their families, and their former employers, including governmental employers.

COBRA provides certain former employees, retirees, spouses, former spouses and dependent children the right to temporary continuation of health coverage at group rates. COBRA generally applies to multi-employer plans and employer-sponsored group health plans, including those of state or local governments under the Public Health Service Act. The ARRA premium subsidy provision is effective beginning February 17, 2009, the date of enactment of ARRA. It allows

assistance eligible individuals to continue coverage at a reduced rate, without cost to the former employer. The ARRA premium subsidy provision also applies to continuation coverage under the Federal Employees Health Benefit Program (FEHBP) and to insurers required to offer continuation coverage under state laws similar to Federal COBRA.

Under the new provision, an assistance eligible individual is generally an individual who:

- (1) Is a qualified beneficiary as the result of an involuntary termination during the period from September 1, 2008, through December 31, 2009,
- (2) Is eligible for COBRA continuation coverage at any time during that period, and
- (3) Elects the coverage.

The new requirement applies to group health plans that are subject to the Federal COBRA continuation coverage requirements or to similar requirements under state law, as well as to the FEHBP, all of which are referred to under ARRA as "COBRA." Under the new law, assistance-eligible individuals are required to pay only 35 percent of the COBRA premium. If you are an employer with such a plan and you receive a payment of 35 percent of the premium from an assistance-eligible individual, you must treat the 35 percent payment by assistance eligible individuals as full payment. However, you will be reimbursed for the 65 percent of the premium not paid by the assistance eligible individuals. The reimbursement is made through a credit against the employer's employment tax liabilities. Employers will take the 65 percent credit on their 2009 payroll tax returns (e.g., Form 941, Employer's QUARTERLY Federal Tax Return) which have been modified for this purpose.

An employer may allow an assistance eligible individual to elect coverage different from the coverage under the plan the individual was enrolled in prior to the involuntary termination, and the premium reduction will apply with respect to such different coverage.

The employer cannot pay the 35% of the premium on behalf of the assistance-eligible individual. This amount must be paid by the assistance eligible individual or on his or her behalf by someone other than the employer.

The assistance eligible individual must have actual group coverage at the time of the qualifying event, i.e., the involuntary termination of employment. The qualifying event must occur between September 1, 2008, and December 31, 2009, and the individual must be eligible for COBRA coverage at any time during that period.

If an individual elects COBRA coverage under the special COBRA election period, the coverage is effective only for the first period of coverage beginning on or after February 17, 2009 (generally the period beginning March 1). A group health plan is required to notify any individual with a qualifying event occurring during the period from September 1, 2008, through December 31, 2009, of the availability of the subsidy. If an assistance eligible individual already has COBRA coverage in effect on February 17, 2009, the individual should receive a special notice of the availability of the subsidy. The notices will explain how to apply for the subsidy.

The reduced premium is available only to employees who are involuntarily terminated during the period from September 1, 2008, through December 31, 2009, and their qualified beneficiaries. Employees who leave their jobs voluntarily cannot receive the benefit.

Employers must continue to accept the 35 percent premium payment from or on behalf of assistance eligible individuals and claim a credit on Form 941, Form 943, or Form 944 for the 65 percent until the assistance eligible individual is no longer eligible for the premium reduction. This occurs at the earliest of:

- The first date the individual becomes eligible for other group health plan coverage or Medicare, or
- Nine months after the first day of the first month for which the premium reduction applies to that individual, or
- The date the individual ceases to be eligible for COBRA continuation coverage.

Employers must maintain supporting documentation for the credit claimed. This includes but is not limited to:

- Documentation of receipt of the assistance-eligible individual's 35 percent share of the premium.
- In the case of insured plans: A copy of invoice or other supporting statement from the insurance carrier and proof of timely payment of the full premium to the insurance carrier.
- In the case of self-insured plans, proof of the premium amount and proof of the coverage provided to the assistance eligible individuals.
- Attestation (or declaration) of involuntary termination, including the date of the involuntary termination (which must be during the period from September 1, 2008, to December 31, 2009), for each covered employee whose involuntary termination is the basis for eligibility for the subsidy.

More information is available through a Q&A section on the [irs.gov site](http://www.irs.gov/pub/irs-pdf/i941.pdf). See <http://www.irs.gov/pub/irs-pdf/i941.pdf> for specific details on reporting procedures.

FSLG COMPLETES REPORT ON COMMUNITY COLLEGES

BY HANS VENABLE, FSLG SENIOR ANALYST

In March 2009, FSLG issued a report on its market segment compliance project on community colleges. The purpose of the project was to measure the compliance level among governmental community colleges and to identify the types of noncompliance issues found in this customer base. From a universe of 983 public community colleges currently operating in the United States, FSLG selected 88 community colleges through random sampling on which to conduct employment tax examinations.

The primary measure of compliance for closed examinations is the “change rate.” This indicates how many cases resulted in either an assessment of additional tax or the issuance of an advisory related to issues that need to be changed to avoid assessment of additional tax in the future. Of the cases sampled, 76 percent resulted in a change. 50 percent of the cases resulted in a tax assessment. There were 161 quarters on which additional tax was assessed for a total of \$614,412, for an average of \$3,816 per quarter changed.

As a result of the project examinations, 140 delinquent information returns (Forms 1099 or W-2) and six delinquent tax returns (Form 941 or 945) were secured.

Noncompliance Issues

The secondary goal of this project was to identify the common areas of noncompliance within this market segment. The following is a breakdown of the major categories of issues that were identified as problems in the sample selected. The numbers in parentheses indicate the number of times this issue was identified in the cases included in the project:

Information Reporting for Education (96): These include failure to issue Forms W-2, Forms 1099, as well as failure to properly collect Forms W-4, and W-9, for recipients of educational benefits. Form W-9, Request for Taxpayer Identification Number and Certification, or its equivalent must be furnished to each person who receives reportable payments or benefits from a government entity in order to verify the recipient’s taxpayer identification number. This includes recipients of educational benefits and scholarships.

Benefits Provided to Employee (54): This category includes failures to properly include in employee income different types of benefits provided, including:

- Meals provided without qualifying travel

- Expense allowances not meeting accountable plan requirements, and not included in income
- Use of employer-provided cell phones not meeting accountable plan requirements
- Other benefits, including taxable clothing and uniforms provided

Worker and Payment Reclassification (34): Workers who should be considered employees treated as independent contractors, or payments that should be treated as wages treated as nonemployee compensation.

Section 218 Coverage (10): Failure to properly apply social security coverage rules to workers covered by a Section 218 Agreement.

Other Issues

The high “change rate” (76%) of examinations conducted on community colleges selected at random indicates a significant level of non-compliance among community colleges. Therefore, FSLG plans to conduct a series of phone forums with community colleges to provide more specific information to help them with the most common compliance issues cited in the report.

Resources for Information on the Technical Issues

FSLG and the IRS have many resources available for information on employment tax issues.

The [Taxable Fringe Benefit Guide](#) and IRS [Publication 15-B](#), Employer’s Tax Guide to Fringe Benefits, contain information about:

- Achievement awards and prizes
- De minimis fringe benefits
- Educational benefits
- Employee expense allowances
- Use of employer vehicle
- Meals and lodging expenses
- Cafeteria plans
- Working condition fringe benefits

[Publication 15](#), Employer’s Tax Guide (Circular E) and [Publication 15-A](#), Employer’s Supplemental Tax Guide, contain information about:

- Determination of who is an employee
- Employer responsibilities when hiring
- Employer recordkeeping responsibilities
- Withholding and filing returns

- Backup withholding
- Form W-2 reporting
- Reporting for independent contractors

For information on Section 218 Agreements, and social security coverage for state and local government employers, see [Publication 963](#), Federal State Reference Guide.

NOTICE 2009-46 ADDRESSES CELL PHONE USE

FROM THE FSLG WEBSITE

The widespread use of employer-owned cell phones by government employees has raised many questions recently about the proper tax treatment of these items.

The IRS has issued [Notice 2009-46](#), requesting public comments from the public regarding proposals to simplify procedures for substantiating employee cell phone use when cell phones are provided by the employer.

Government employers frequently provide their employees with cell phones and pagers to employees to conduct business. To the extent that the employee uses the employer's cell phone for business purposes, the value of the use is excludable as a working condition fringe benefit. However, any personal use is income to the employee.

In 1989, cellular telephones were designated as "listed property" under the Internal Revenue Code, and are therefore subject to special substantiation requirements. Although the use of these phones is much more widespread and economical today, they remain listed property under law and are subject to special recordkeeping requirements to establish the business use of the property. To be able to exclude the value of use of an employer-owned cell phone by an employee from income, the employer must have some method requiring the employee to keep records that distinguish business from personal phone use.

Under current requirements, employee should keep a record of each call and the time it is incurred, as well as its business purpose. If calls are itemized on a monthly statement, they should be identifiable as personal or business, and the employee should retain any supporting evidence of the business calls. This information should be submitted to the employer, who must maintain these records to support the exclusion of the phone use from the employee's wages. The value assigned to individual personal calls must include a pro rata share of monthly service charges. The fair market value of any use that represents personal use is included in the wages of the employee. If the extent of personal use cannot be established, the entire value of the cell

phone is taxable income to the employee.

Because of the potentially large volume of calls made by employees, as well as the variety of telephone service provider pricing systems, the recordkeeping requirement may be burdensome to employees as well as employers. In order to simplify reporting requirements, and eliminate the need for detailed records on each call, Notice 2009-46 presents three proposals for simplifying the reporting burden:

- Minimal personal use method
- Safe harbor substantiation method
- Statistical sampling method

Comments on any of these three proposals must be submitted in writing on or before September 4, 2009. See the [Notice](#) for more information on the proposals and procedures for comment.

For more information on employee use of cell phones, see the [FSLG Fact Sheet](#).

SECTION 3402(t) WITHHOLDING DELAYED ONE YEAR *FROM THE FSLG WEBSITE*

The American Recovery and Reinvestment Act of 2009, signed into law February 17, delays the new withholding requirement for government payments under Internal Revenue Code subsection 3402(t) to contractors for one year. The requirement now applies for payments made after December 31, 2011.

Proposed Regulations [REG-158747-06] were published in the Federal Register December 5, 2008, for new Internal Revenue Code subsection 3402(t). This subsection, created by the Tax Increase Prevention and Reconciliation Act of 2005, originally required that payments by governmental entities for goods or services after December 31, 2010, are subject to 3% income tax withholding, with some exceptions. The implementation date has now been changed by statute to payments after December 31, 2011. For more details, please see the Proposed Regulations, which can be accessed [here](#).

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